

# PERAC AUDIT REPORT



## State Contributory Retirement System

JAN. 1, 2000 - DEC. 31, 2003 / PERAC 03:10-021-10



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# PERAC

COMMONWEALTH OF MASSACHUSETTS | PUBLIC EMPLOYEE RETIREMENT ADMINISTRATION COMMISSION

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KENNETH J. DONNELLY | ERIC A. KRISS | JAMES M. MACHADO | DONALD R. MARQUIS

JOSEPH E. CONNARTON, *Executive Director*

November 9, 2004

The Public Employee Retirement Administration Commission has completed an examination of the State Retirement System pursuant to G.L. c. 32, § 21. The examination covered the period from January 1, 2000 to December 31, 2003. This audit was conducted in accordance with the accounting and management standards established by the Public Employee Retirement Administration Commission in regulation 840 CMR 25.00. Additionally, all supplementary regulations approved by PERAC and on file at PERAC are listed in this report.

In our opinion, the financial records and management functions are being performed in conformity with the standards established by the Public Employee Retirement Administration Commission with the exception of those noted in the findings presented in this report.

In closing, I acknowledge the work of examiners James Ryan, James Sweeney, and James Tivnan who conducted this examination and express appreciation to the Board of Retirement and staff for their courtesy and cooperation.

Sincerely,



Joseph E. Connarton  
Executive Director



## **State Retirement System**

### **EXPLANATION OF FINDINGS AND RECOMMENDATIONS**

#### **FOR THE FOUR YEAR PERIOD ENDING DECEMBER 31, 2003**

##### **1. Accounting**

The State Employee Retirement Board (SRB) maintains their general ledger on a cash basis, which is recorded annually. The primary source for expenditures recorded is withdrawals from the Pension Reserves Investment Trust, which are transferred to the Commonwealth's General Fund. The withdrawals are requested by the Office of the Comptroller and reviewed by the State Treasurer's Department and the SRB. Under this arrangement it is difficult to prepare standard financial reports. The SRB general ledger and financial reports are maintained on a calendar-year basis in compliance with PERAC guidelines and Chapter 32 reporting requirements. The Office of the Comptroller and the State Treasurer's Department report on a fiscal year basis. Consequently, administrative expenses at times report significant period-to-period fluctuations. In addition, the administrative expense line item includes expenses for travel, consultants and other expense accounts that should be separately reported in compliance with PERAC guidelines and Chapter 32 reporting requirements. Within this system, it is difficult to compile financial information that is comparable.

##### **Recommendation:**

Generally Accepted Accounting Principles (GAAP) states that all entries should be made in the month in which the transactions occur. The SRB, in conjunction with the State Treasurer's Department and Office of the Comptroller, should continue to work together to ensure that expenses incurred are recorded in compliance with GAAP which requires matching the expense to the period when it was incurred. This process should minimize significant period-to-period reporting fluctuations within expense categories. Furthermore, major components of the current SRB administrative expense line item should be reported in detail to conform with PERAC accounting guidelines. Timely and comprehensive reporting of expenditures is essential for good business practices and for maintaining an effective system of internal financial controls.

##### **Board Response:**

The Board expects to refine the reporting of its administrative expense line item so that certain expenditures will be reported separately. As noted by PERAC, the SRB financial reports are maintained on a calendar year basis in accordance with PERAC guidelines and Chapter 32 requirements, while reporting by the Office of the State Comptroller and State Treasury occurs on a fiscal years basis. The Board will endeavor to show only expenses incurred in the calendar year on its Annual Statement. The Board anticipates that any carryover will be shown as a balance being brought forward. Additionally, the Board will endeavor as the year end approaches to minimize any carryover in expense or appropriation accounts. The Board expects this would provide a reader of the Annual Statement a clearer picture of Board expenditures.

Arrangements are also being made for the Board to receive its expense appropriation account balance from the State Treasury as of January 1 of each calendar year to assist it in recording expenditure detail in separate general ledger accounts on a monthly basis. Moreover, the Board is reviewing whether supplementary documentation should be included with its Annual Statement.

## **State Retirement System**

### **EXPLANATION OF FINDINGS AND RECOMMENDATIONS (Continued)**

#### **FOR THE FOUR YEAR PERIOD ENDING DECEMBER 31, 2003**

Finally, it may need to be considered whether legislation should be discussed to address the Board's specific financial reporting requirements.

#### **2. Appropriations**

Over the four-year period ending 12/31/03, the general ledger (GL) account balance in GL account number 4894 "Pension Fund Appropriation" varied an average of 10.5% from the amount appropriated from the Commonwealth's Pension Liability Fund. For example, for the calendar year ending 12/31/03, there was a \$57 million dollar overstated variance between the GL and the appropriated amount from the Commonwealth's Pension Liability Fund. Of this variance, we determined that \$12 million dollars related to funds divested during the year from the PRIT fund. The remaining \$45 million dollar variance appears to be COLA or 3(8)(C) reimbursements.

#### **Recommendation:**

On an annual basis, a formal account reconciliation should be prepared which provides detail of the components that make up the balance in GL account number 4894 "Pension Fund Appropriation." Any item determined to be unrelated to the Pension Fund Appropriation account should be reclassified to the correct GL account.

#### **Board Response:**

As noted in Section 1 the differing financial reporting requirements of the Board and the various state agencies with which it is required to interact to administer its operations account for the some of the variances noted. However, the Board through its record keeping has been able to clearly address these variances and reconcile the account in question. The Board will endeavor to smooth out the appropriations by minimizing the amount of any carry over from the previous year. Again, this will give a reader of the Annual Statement a clearer picture of Board funding.

#### **3. Annual Statement**

The Annual Statements submitted over the audit period do not contain the investment income detail required by PERAC accounting guidelines. Reporting is limited to net results of investment activities rather than the specific categories that comprise them such as interest and dividend income, realized gains/losses from securities' transactions, and unrealized gains/losses from securities' transactions. Disbursements related to investment income such as management fees and consulting fees are similarly not separately reported.

#### **Recommendation:**

The SRB should receive sufficient detail from PRIT and the custodian, Mellon Bank, to comply with 840 CMR 5.03 and G.L. c. 32, § 20 (5)(h). Incorporating the reporting detail required should produce a comprehensive Annual Statement that may allow readers to more adequately assess the financial condition of the System.

## State Retirement System

### **EXPLANATION OF FINDINGS AND RECOMMENDATIONS (Continued)**

**FOR THE FOUR YEAR PERIOD ENDING DECEMBER 31, 2003**

#### **Board Response:**

The Board receives much of the information in question from the Pension Reserves Investment Management Board and does present it in a general form in its Annual Statement. In addition to the limitations set forth in the responses above, and in light of its unique relationship with the State Treasury and Office of the Comptroller in administering the financial aspects of the retirement system, the Board is reviewing various ways which it may record the investment income detail required by PERAC's accounting guidelines.

**4. Membership:** PERAC auditors sampled members' deduction rates to determine that correct percentages are being withheld and that the additional 2% deduction is withheld from those members who earn over \$30,000 and were hired after January 1, 1979. The sample yielded a 15% error rate in the 2% additional deduction. The additional deduction errors' rate ranged from 1.7% to 2.4%.

**Recommendation:** The Board must comply with G.L. c 32 § 22 (1)(b), 840 CMR 8.03, and PERAC MEMO #43/1999, defining 2% additional deductions. The Board receives the deduction data from HRCM. The Board must work with the Treasurer's payroll office to insure compliance with the applicable statutes and regulations.

#### **Board Response:**

The Board maintains ongoing discussions with the Office of the State Comptroller regarding the 2% additional deduction and the manner it is reported by the HRCMS payroll system. The list of test cases concerning the 2% additional deductions provided by the PERAC auditors has been forwarded to the Comptroller and HRCMS for their review. The Board expects this dialogue will continue and will respond appropriately to the concerns raised.

It should also be noted that the Board has been meeting on a regular basis with the University of Massachusetts that operates a corollary payroll system to HRCMS for its employees and the parties are continuing to address the same issue.

Additionally, the Board will modify its audit of incoming retirement contributions to not only check the base rate amount, but the additional 2% amount as well. This will ensure going forward that the correct amounts are being received and credited to member's accounts. The Board expects to adjust any affected members' accounts once corrective measures are taken by the respective payroll system and reported.

Finally, the Legislature has previously made employees of certain independent entities, i.e. educational collaboratives, members of the State Retirement System. These entities are not part of the Commonwealth's payroll system and independently submit payroll information to the Board on

## **State Retirement System**

### **EXPLANATION OF FINDINGS AND RECOMMENDATIONS (Continued)**

#### **FOR THE FOUR YEAR PERIOD ENDING DECEMBER 31, 2003**

a monthly basis. There is frequent turnover in the staffs of these entities and the level of knowledge regarding Chapter 32 payroll deductions varies.

#### **Administrative Observation**

The primary database for the 86,000 active members who participate in the system and the 50,000 members who receive benefits from the system is based on a series of antiquated COBOL language programs. These older technologies have limited current and future available support. The SRB should consider converting this information to a current database technology. This would improve the information flow thereby significantly benefiting all users.

#### **Final Determination**

*PERAC auditors will follow-up in six (6) months to ensure that the appropriate actions have been taken regarding the audit findings.*

# State Retirement System

## STATEMENT OF LEDGER ASSETS AND LIABILITIES

**FOR THE FOUR YEAR PERIOD BEGINNING JANUARY 1, 2000  
AND ENDING DECEMBER 31, 2003**

	<b>FOR THE PERIOD ENDING DECEMBER 31,</b>			
<b>ASSETS</b>	<b>2003</b>	<b>2002</b>	<b>2001</b>	<b>2000</b>
Cash	\$153,021	\$86,652	\$0	\$0
PRIT Core Fund	14,834,328,039	12,128,062,136	13,597,726,327	14,385,683,843
Interest Due and Accrued	0	0	0	0
Accounts Receivable	1,805,551	1,543,078	13,556,674	13,095,503
Accounts Payable	<u>0</u>	<u>0</u>	<u>0</u>	
<b>TOTAL</b>	<b><u>\$14,836,286,611</u></b>	<b><u>\$12,129,691,865</u></b>	<b><u>\$13,611,283,001</u></b>	<b><u>\$14,398,779,347</u></b>
<b>FUND BALANCES</b>				
Annuity Savings Fund	\$3,343,145,450	\$3,258,567,859	\$3,341,931,141	\$3,131,943,807
Annuity Reserve Fund	1,197,166,487	1,077,078,779	781,934,702	745,150,286
Pension Fund	0	0	0	0
Military Service Fund	73,153	82,423	89,558	90,326
Expense Fund	0	0	0	0
Pension Reserve Fund	<u>10,295,901,521</u>	<u>7,793,962,804</u>	<u>9,487,327,600</u>	<u>10,521,594,928</u>
<b>TOTAL</b>	<b><u>\$14,836,286,611</u></b>	<b><u>\$12,129,691,865</u></b>	<b><u>\$13,611,283,001</u></b>	<b><u>\$14,398,779,347</u></b>



## State Retirement System

### STATEMENT OF CHANGES IN FUND BALANCES

**FOR THE FOUR YEAR PERIOD BEGINNING JANUARY 1, 2000  
AND ENDING DECEMBER 31, 2003**

	<b>Annuity Savings Fund</b>	<b>Annuity Reserve Fund</b>	<b>Pension Fund</b>	<b>Military Service Fund</b>	<b>Expense Fund</b>	<b>Pension Reserve Fund</b>	<b>Total All Funds</b>
<b>Beginning Balance (2000)</b>	\$2,943,631,658	\$741,342,726	\$0	\$96,536	\$0	\$11,008,074,085	<b>\$14,693,145,006</b>
Receipts	365,002,721	22,082,548	493,780,469	1,448	4,771,543	(310,983,641)	<b>574,655,088</b>
Interfund Transfers	(113,426,319)	106,491,841	182,437,653	(7,658)	0	(175,495,517)	<b>0</b>
Disbursements	<u>(63,264,253)</u>	<u>(124,766,829)</u>	<u>(676,218,122)</u>	<u>0</u>	<u>(4,771,543)</u>	<u>0</u>	<b><u>(869,020,748)</u></b>
<b>Ending Balance (2000)</b>	<b>3,131,943,807</b>	<b>745,150,286</b>	<b>0</b>	<b>90,326</b>	<b>0</b>	<b>10,521,594,927</b>	<b>14,398,779,347</b>
Receipts	384,230,076	22,559,174	532,891,728	1,680	5,824,240	(899,618,496)	<b>45,888,401</b>
Interfund Transfers	(120,141,596)	120,144,044	134,648,833	(2,448)	0	(134,648,833)	<b>0</b>
Disbursements	<u>(54,101,146)</u>	<u>(105,918,801)</u>	<u>(667,540,560)</u>	<u>0</u>	<u>(5,824,240)</u>	<u>0</u>	<b><u>(833,384,747)</u></b>
<b>Ending Balance (2001)</b>	<b>3,341,931,141</b>	<b>781,934,702</b>	<b>0</b>	<b>89,558</b>	<b>0</b>	<b>9,487,327,599</b>	<b>13,611,283,001</b>
Receipts	367,350,993	27,801,901	434,528,120	872	5,967,605	(1,322,186,335)	<b>(486,536,845)</b>
Interfund Transfers	(400324433.02)	396383097.43	375127802.92	(8007.53)	0	(371,178,460)	<b>0</b>
Disbursements	<u>(50389843.08)</u>	<u>(129040920.86)</u>	<u>(809655923.07)</u>	<u>0.00</u>	<u>(5,967,605)</u>	<u>0</u>	<b><u>(995,054,292)</u></b>
<b>Ending Balance (2002)</b>	<b>3258567858.55</b>	<b>1077078779.09</b>	<b>0.00</b>	<b>82422.62</b>	<b>0</b>	<b>7,793,962,804</b>	<b>12,129,691,864</b>
Receipts	371843627.30	31918908.04	361409742.47	309.25	4,965,347	3,007,994,876	<b>3,778,132,810</b>
Interfund Transfers	(235802549.65)	231407279.73	510461007.58	(9578.79)	0	(506,056,159)	<b>0</b>
Disbursements	<u>(51,463,486)</u>	<u>(143,238,480)</u>	<u>(871,870,750)</u>	<u>0</u>	<u>(4,965,347)</u>	<u>0</u>	<b><u>(1,071,538,064)</u></b>
<b>Ending Balance (2003)</b>	<b><u>\$3,343,145,450</u></b>	<b><u>\$1,197,166,487</u></b>	<b><u>\$0</u></b>	<b><u>\$73,153</u></b>	<b><u>\$0</u></b>	<b><u>\$10,295,901,521</u></b>	<b><u>\$14,836,286,611</u></b>

# State Retirement System

## STATEMENT OF INCOME

**FOR THE FOUR YEAR PERIOD BEGINNING JANUARY 1, 2000  
AND ENDING DECEMBER 31, 2003**

	<b>FOR THE PERIOD ENDING DECEMBER 31,</b>			
	<b>2003</b>	<b>2002</b>	<b>2001</b>	<b>2000</b>
<b>Annuity Savings Fund:</b>				
Members Deductions	\$326,878,987	\$313,170,432	\$317,732,767	\$294,445,116
Transfers from other Systems	5,007,324	6,167,404	7,245,325	9,905,957
Member Make Up Payments and Redeposits	10,052,962	7,562,839	3,201,348	2,743,743
Investment Income Credited to Member Accounts	<u>29,904,353</u>	<u>40,450,319</u>	<u>56,050,635</u>	<u>57,907,905</u>
<b>Sub Total</b>	<b><u>371,843,627</u></b>	<b><u>367,350,993</u></b>	<b><u>384,230,076</u></b>	<b><u>365,002,721</u></b>
<b>Annuity Reserve Fund:</b>				
Investment Income Credited Annuity Reserve Fund	<u>31,918,908</u>	<u>27,801,901</u>	<u>22,559,174</u>	<u>22,082,548</u>
<b>Pension Fund:</b>				
3 (8) (c) Reimbursements from Other Systems	21,166,966	17,207,451	17,331,316	18,039,415
Received from Commonwealth for COLA and Survivor Benefits	0	0	0	0
Pension Fund Appropriation	<u>340,242,777</u>	<u>417,320,669</u>	<u>515,560,412</u>	<u>475,741,055</u>
<b>Sub Total</b>	<b><u>361,409,742</u></b>	<b><u>434,528,120</u></b>	<b><u>532,891,728</u></b>	<b><u>493,780,469</u></b>
<b>Military Service Fund:</b>				
Contribution Received from Municipality on Account of Military Service	0	0	0	0
Investment Income Credited Military Service Fund	<u>309</u>	<u>872</u>	<u>1,680</u>	<u>1,448</u>
<b>Sub Total</b>	<b><u>309</u></b>	<b><u>872</u></b>	<b><u>1,680</u></b>	<b><u>1,448</u></b>
<b>Expense Fund:</b>				
Expense Fund Appropriation	0	0	0	0
Investment Income Credited to Expense Fund	<u>4,965,347</u>	<u>5,967,605</u>	<u>5,824,240</u>	<u>4,771,543</u>
<b>Sub Total</b>	<b><u>4,965,347</u></b>	<b><u>5,967,605</u></b>	<b><u>5,824,240</u></b>	<b><u>4,771,543</u></b>
<b>Pension Reserve Fund:</b>				
Federal Grant Reimbursement	4,558,916	4,411,727	3,986,700	3,355,707
Pension Reserve Appropriation	0	0	0	0
Interest Not Refunded	869,432	1,011,134	1,148,783	1,401,611
Excess Investment Income	<u>3,002,566,528</u>	<u>(1,327,609,197)</u>	<u>(904,753,978)</u>	<u>(315,740,958)</u>
<b>Sub Total</b>	<b><u>3,007,994,876</u></b>	<b><u>(1,322,186,335)</u></b>	<b><u>(899,618,496)</u></b>	<b><u>(310,983,641)</u></b>
<b>TOTAL RECEIPTS</b>	<b><u>\$3,778,132,810</u></b>	<b><u>(\$486,536,845)</u></b>	<b><u>\$45,888,401</u></b>	<b><u>\$574,655,088</u></b>

# State Retirement System

## STATEMENT OF DISBURSEMENTS

**FOR THE FOUR YEAR PERIOD BEGINNING JANUARY 1, 2000  
AND ENDING DECEMBER 31, 2003**

	<b>FOR THE PERIOD ENDING DECEMBER 31,</b>			
	<b>2003</b>	<b>2002</b>	<b>2001</b>	<b>2000</b>
<b>Annuity Savings Fund:</b>				
Refunds to Members	\$49,143,736	\$46,704,136	\$50,916,052	\$60,585,174
Transfers to other Systems	<u>2,319,750</u>	<u>3,685,707</u>	<u>3,185,093</u>	<u>2,679,079</u>
<b>Sub Total</b>	<b><u>51,463,486</u></b>	<b><u>50,389,843</u></b>	<b><u>54,101,146</u></b>	<b><u>63,264,253</u></b>
<b>Annuity Reserve Fund:</b>				
Annuities Paid	139,513,670	125,381,429	102,839,533	121,088,140
Option B Refunds	<u>3,724,810</u>	<u>3,659,492</u>	<u>3,079,268</u>	<u>3,678,690</u>
<b>Sub Total</b>	<b><u>143,238,480</u></b>	<b><u>129,040,921</u></b>	<b><u>105,918,801</u></b>	<b><u>124,766,829</u></b>
<b>Pension Fund:</b>				
Pensions Paid				
Regular Pension Payments	679,003,917	610,667,324	508,824,463	476,941,681
Survivorship Payments	43,268,948	39,046,448	36,657,678	34,646,454
Ordinary Disability Payments	8,621,236	8,770,430	8,771,428	8,553,452
Accidental Disability Payments	60,619,825	56,464,820	54,378,782	49,070,830
Accidental Death Payments	10,174,068	10,110,045	9,693,937	9,292,375
Section 101 Benefits	3,022,827	2,942,452	2,846,477	2,715,365
3 (8) (c) Reimbursements to Other Systems	5,545,689	5,057,790	4,918,380	4,622,992
COLA's Paid	61,614,240	76,596,615	41,449,414	90,374,974
Chapter 389 Beneficiary Increase Paid	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
<b>Sub Total</b>	<b><u>871,870,750</u></b>	<b><u>809,655,923</u></b>	<b><u>667,540,560</u></b>	<b><u>676,218,122</u></b>
<b>Military Service Fund:</b>				
Return to Municipality for Members Who Withdrew Their Funds	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
<b>Expense Fund:</b>				
Board Member Stipend	0	0	0	0
Salaries	774,721	2,039,701	1,174,453	1,522,415
Legal Expenses	0	0	0	0
Medical Expenses	0	0	0	0
Travel Expenses	0	0	0	0
Administrative Expenses	1,440,626	1,427,904	1,648,037	1,249,128
Furniture and Equipment	0	0	0	0
Management Fees	0	0	0	0
Custodial Fees	0	0	0	0
PERAC Expense	<u>2,750,000</u>	<u>2,500,000</u>	<u>3,001,750</u>	<u>2,000,000</u>
<b>Sub Total</b>	<b><u>4,965,347</u></b>	<b><u>5,967,605</u></b>	<b><u>5,824,240</u></b>	<b><u>4,771,543</u></b>
<b>TOTAL DISBURSEMENTS</b>	<b><u>\$1,071,538,064</u></b>	<b><u>\$995,054,292</u></b>	<b><u>\$833,384,747</u></b>	<b><u>\$869,020,748</u></b>

# State Retirement System

## INVESTMENT INCOME

**FOR THE FOUR YEAR PERIOD BEGINNING JANUARY 1, 2000  
AND ENDING DECEMBER 31, 2003**

	FOR THE PERIOD ENDING DECEMBER 31,			
	2003	2002	2001	2000
<b>Investment Income Received From:</b>				
Cash				
Short Term Investments				
Fixed Income				
Equities				
Pooled or Mutual Funds	<u>3,069,355,446</u>	<u>(1,253,388,501)</u>	<u>(820,318,250)</u>	<u>(230,977,514)</u>
Commission Recapture				
<b>TOTAL INVESTMENT INCOME</b>	<b><u>3,069,355,446</u></b>	<b><u>(1,253,388,501)</u></b>	<b><u>(820,318,250)</u></b>	<b><u>(230,977,514)</u></b>
<b>Plus:</b>				
Increase in Amortization of Fixed Income Securities				
Realized Gains				
Unrealized Gains				
Interest Due and Accrued on Fixed Income Securities - Current Year				
<b>Sub Total</b>	<b><u>0</u></b>	<b><u>0</u></b>	<b><u>0</u></b>	<b><u>0</u></b>
<b>Less:</b>				
Decrease in Amortization of Fixed Income Securities				
Paid Accrued Interest on Fixed Income Securities				
Realized Loss				
Unrealized Loss				
Custodial Fees Paid				
Consultant Fees Paid				
Management Fees Paid				
Board Member Stipend				
Interest Due and Accrued on Fixed Income Securities - Prior Year				
<b>Sub Total</b>	<b><u>0</u></b>	<b><u>0</u></b>	<b><u>0</u></b>	<b><u>0</u></b>
<b>NET INVESTMENT INCOME</b>	<b><u>3,069,355,446</u></b>	<b><u>(1,253,388,501)</u></b>	<b><u>(820,318,250)</u></b>	<b><u>(230,977,514)</u></b>
<b>Income Required:</b>				
Annuity Savings Fund	29,904,353	40,450,319	56,050,635	57,907,905
Annuity Reserve Fund	31,918,908	27,801,901	22,559,174	22,082,548
Military Service Fund	309	872	1,680	1,448
Expense Fund	<u>4,965,347</u>	<u>5,967,605</u>	<u>5,824,240</u>	<u>4,771,543</u>
<b>TOTAL INCOME REQUIRED</b>	<b><u>66,788,917</u></b>	<b><u>74,220,696</u></b>	<b><u>84,435,729</u></b>	<b><u>84,763,444</u></b>
Net Investment Income	<u>3,069,355,446</u>	<u>(1,253,388,501)</u>	<u>(820,318,250)</u>	<u>(230,977,514)</u>
Less: Total Income Required	<u>66,788,917</u>	<u>74,220,696</u>	<u>84,435,729</u>	<u>84,763,444</u>
<b>EXCESS INCOME TO THE PENSION RESERVE FUND</b>	<b><u>\$3,002,566,528</u></b>	<b><u>(\$1,327,609,197)</u></b>	<b><u>(\$904,753,978)</u></b>	<b><u>(\$315,740,958)</u></b>

## State Retirement System

### **STATEMENT OF ALLOCATION OF INVESTMENTS OWNED**

(percentages by category)

**FOR THE FOUR YEAR PERIOD ENDING DECEMBER 31, 2003**

	<b>BOOK VALUE*</b>	<b>MARKET VALUE</b>	<b>PERCENTAGE OF TOTAL ASSETS</b>	<b>PERCENTAGE ALLOWED*</b>
Cash		\$153,021	0.00%	100
PRIT Core Fund		<u>14,834,328,039</u>	<u>100.00%</u>	100
<b>GRAND TOTALS</b>	<b><u>\$0</u></b>	<b><u>\$14,834,481,060</u></b>	<b><u>100.00%</u></b>	

\* The book value differs from the market value for individually owned Fixed Income Securities which are valued at amortized cost which is the original cost of the investment plus or minus any bond discount or bond premium calculated ratably to maturity. All other investments are reflected at their quoted market value.

For the year ending December 31, 2003, the rate of return for the investments of the State Retirement System was 26.43%. For the five-year period ending December 31, 2003, the rate of return for the investments of the State Retirement System averaged 5.77%. For the 19-year period ending December 31, 2003, since PERAC began evaluating the returns of the retirement systems, the rate of return of the investments of the State Retirement System was 11.45%.

## **State Retirement System**

### **SUPPLEMENTARY INVESTMENT REGULATIONS**

#### **FOR THE FOUR YEAR PERIOD ENDING DECEMBER 31, 2003**

The State Retirement System has not submitted supplementary investment regulations to PERAC.

## **State Retirement System**

### **NOTES TO FINANCIAL STATEMENTS**

**FOR THE FOUR YEAR PERIOD ENDING DECEMBER 31, 2003**

#### **NOTE 1 - THE SYSTEM**

The plan is a contributory defined benefit plan covering all State Retirement System member unit employees deemed eligible by the retirement board, with the exception of school department employees who serve in a teaching capacity. The Teachers' Retirement Board administers the pensions of such school employees.

Instituted in 1937, the System is a member of the Massachusetts Contributory Retirement System and is governed by Chapter 32 of the Massachusetts General Laws. Membership in the plan is mandatory immediately upon the commencement of employment for all permanent, full-time employees.

The system provides for retirement allowance benefits up to a maximum of 80% of a member's highest three year average annual rate of regular compensation. Benefit payments are based upon a member's age, length of creditable service, level of compensation, and group classification.

Members become vested after ten years of creditable service. A superannuation retirement allowance may be received upon the completion of twenty years of service or upon reaching the age of 55 with ten years of service. Normal retirement for most employees occurs at age 65 (for certain hazardous duty and public safety positions, normal retirement is at age 55).

A retirement allowance consists of two parts: an annuity and a pension. A member's accumulated total deductions and a portion of the interest they generate constitute the annuity. The differential between the total retirement benefit and the annuity is the pension. The average retirement benefit is approximately 75 - 85% pension and 15 - 25% annuity.

Active members contribute either 5, 7, 8, or 9% of their gross regular compensation. Members joining the retirement system after January 1, 1979 must contribute an additional 2% on regular compensation earned at a rate in excess of \$30,000. The percentage rate is keyed to the date upon which an employee's membership commences. These deductions are deposited in the Annuity Savings Fund and earn interest at a rate determined by the Executive Director of PERAC according to statute. When a member's retirement becomes effective, his/her deductions and related interest are transferred to the Annuity Reserve Fund. Any cost-of-living adjustment granted between 1981 and 1997 and any increase in other benefits imposed by state law during that period are borne by the state.

The pension portion of any retirement benefit is paid from the Pension Fund of the System. The governmental unit employing the member must annually appropriate and contribute the amount of current year pension payments as indicated on the most recent funding schedule as approved by PERAC's Actuary. Until recently, retirement systems were paying only the actual retirement

## **State Retirement System**

### **NOTES TO FINANCIAL STATEMENTS (Continued)**

#### **FOR THE FOUR YEAR PERIOD ENDING DECEMBER 31, 2003**

benefits that were due each year. Systems had no statutory authorization to put aside any money for the future benefits of employees who are now working. Large unfunded liabilities resulted from operating upon this pay-as-you-go basis. In 1977, legislation authorized local governments to appropriate funds to meet future pension obligations.

In 1983, additional legislation was passed requiring the transfer of investment earnings (in excess of the amount credited to member accounts) into the Pension Reserve Fund. These initiatives have significantly reduced the rate of growth of the retirement systems' unfunded liabilities, and in some systems have actually eliminated such liability.

Administrative expenses are funded through investment income of the system.

Members who become permanently and totally disabled for further duty may be eligible to receive a disability retirement allowance. The amount of benefits to be received in such cases is dependent upon several factors including: whether or not the disability is work related, the member's age, years of creditable service, level of compensation, veteran's status, and group classification.

Employees who resign from service and who are not eligible to receive a retirement allowance or are under the age of 55 are entitled to request a refund of their accumulated total deductions. In addition, depending upon the number of years of creditable service, such employees are entitled to receive either zero (0%) percent, fifty (50%) percent, or one hundred (100%) percent of the regular interest which has accrued upon those deductions. Survivor benefits are extended to eligible beneficiaries of members whose death occurs prior to or following retirement.

#### **NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES**

The accounting records of the System are maintained on a calendar year basis in accordance with the standards and procedures established by the Executive Director of Public Employee Retirement Administration Commission.

The Annuity Savings Fund is the fund in which members' contributions are deposited. Active members contribute either 5, 7, 8, or 9% of their gross regular compensation. State Police contribute 12% hired after July 1, 1996. Voluntary contributions, redeposits, and transfers to and from other systems, are also accounted for in this fund. Members' contributions to the fund earn interest at a rate determined by PERAC. Interest for some members who withdraw with less than ten years of service is transferred to the Pension Reserve Fund. Upon retirement, members' contributions and interest are transferred to the Annuity Reserve Fund. Dormant account balances must be transferred to the Pension Reserve Fund after a period of ten years of inactivity.



## **State Retirement System**

### **NOTES TO FINANCIAL STATEMENTS (Continued)**

#### **FOR THE FOUR YEAR PERIOD ENDING DECEMBER 31, 2003**

The Annuity Reserve Fund is the fund to which a member's account is transferred upon retirement from the Annuity Savings Fund and Special Military Service Credit Fund. The annuity portion of the retirement allowance is paid from this fund. Interest is credited monthly to this fund at the rate of 3% annually on the previous month's balance.

The Special Military Service Credit Fund contains contributions and interest for members while on a military leave for service in the Armed Forces who will receive creditable service for the period of that leave.

The Expense Fund contains amounts transferred from investment income for the purposes of administering the retirement system.

The Pension Fund contains the amounts appropriated by the governmental units as established by PERAC to pay the pension portion of each retirement allowance.

The Pension Reserve Fund contains amounts appropriated by the governmental units for the purposes of funding future retirement benefits. Any profit or loss realized on the sale or maturity of any investment or on the unrealized gain of a market valued investment as of the valuation date is credited to the Pension Reserve Fund. Additionally, any investment income in excess of the amount required to credit interest to the Annuity Savings Fund, Annuity Reserve Fund, and Special Military Service Credit Fund is credited to this Reserve account.

The Investment Income Account is credited with all income derived from interest and dividends of invested funds. At year-end the interest credited to the Annuity Savings Fund, Annuity Reserve Fund, Expense Fund, and Special Military Service Credit Fund is distributed from this account and the remaining balance is transferred to the Pension Reserve Fund.

#### **NOTE 3 - SUPPLEMENTARY MEMBERSHIP REGULATIONS**

The State Retirement System submitted the following supplementary membership regulations, which were approved by PERAC on:

December 22, 1992 Membership/Creditable Service

Persons employed over 20 hours in a regular work week to be enrolled as members; eligible employees to be enrolled at inception of employment; proration of creditable service for part-time employees; higher ed employees to receive 6 months of creditable service for 1 year sabbaticals at half pay.

## **State Retirement System**

### **NOTES TO FINANCIAL STATEMENTS (Continued)**

#### **FOR THE FOUR YEAR PERIOD ENDING DECEMBER 31, 2003**

Supplementary membership regulations (continued)

December 22, 1992 Buy-Back of Prior Service

Buy-back of prior non-membership service of 6 consecutive months or less that was part-time, provisional, temporary, temporary provisional or intermittent and was not immediately followed by membership service not be allowed.

October 22, 2002

The Board has adopted Travel Supplemental Regulations under the provisions of G.L. c.7, § 50 and G.L. c.32, § 21(4). (Regulation available upon written request)

## **State Retirement System**

### **NOTES TO FINANCIAL STATEMENTS (Continued)**

#### **FOR THE FOUR YEAR PERIOD ENDING DECEMBER 31, 2003**

##### **NOTE 4 - ADMINISTRATION OF THE SYSTEM**

The System is administered by a five person Board of Retirement consisting of the State Treasurer who shall be a member ex officio, a second member appointed by the governing authority, a third and fourth member who shall be elected by the members in or retired from the service of such system, and a fifth member appointed by the other four board members.

Ex officio Member: Timothy Cahill

Appointed Member: Peter Koutoujian, Sr. Term Expires: 11/30/06

Elected Member: Ralph White Term Expires: 12/31/04

Elected Member: Vacant Term Expires:

Appointed Member: Christopher Condon Term Expires: 12/31/05

The Board members are required to meet at least once a month. The Board must keep a record of all of its proceedings. The Board must annually submit to the appropriate authority an estimate of the expenses of administration and cost of operation of the system. The board must annually file a financial statement of condition for the system with the Executive Director of PERAC.

The following retirement board members and employees are bonded by an authorized agent representing a company licensed to do business in Massachusetts as follows:

Treasurer - Custodian:	)	
Ex officio Member:	)	\$1,000,000 Employee Dishonesty
Elected Member:	)	Hartford Casualty Co.
Appointed Member:	)	
Staff Employee:	)	

## State Retirement System

### NOTES TO FINANCIAL STATEMENTS (Continued)

**FOR THE FOUR YEAR PERIOD ENDING DECEMBER 31, 2003**

#### NOTE 5 - ACTUARIAL VALUATION AND ASSUMPTIONS

The most recent actuarial valuation of the System was prepared by the Public Employee Administration Commission as of January 1, 2004.

The actuarial liability for active members was	\$9,080,709,000
The actuarial liability for vested terminated members was	307,645,000
The actuarial liability for non-vested terminated members was	83,295,000
The actuarial liability for retired members was	<u>9,524,404,000</u>
The total actuarial liability was	<b>18,996,053,000</b>
System assets as of that date were	<u>15,930,753,000</u>
The unfunded actuarial liability was	<b><u>\$3,065,300,000</u></b>
 The ratio of system's assets to total actuarial liability was	 83.9%
As of that date the total covered employee payroll was	\$3,841,606,121

The normal cost for employees on that date was 8.11% of payroll

The normal cost for the employer was 3.64% of payroll

The principal actuarial assumptions used in the valuation are as follows:

**Investment Return:** 8.25% per annum  
**Rate of Salary Increase:** Rates vary by service

#### GASB STATEMENT NO. 25, DISCLOSURE INFORMATION AS OF JANUARY 1, 2004

Actuarial Valuation Date	Actuarial Value of Assets ( a )	Actuarial Accrued Liability ( b )	Unfunded AAL (UAAL) ( b-a )	Funded Ratio ( a/b )	Covered Payroll ( c )	UAAL as a % of Cov. Payroll ( (b-a)/c )
1/1/2004	\$15,930,753,000	\$18,996,053,000	\$3,065,300,000	83.9%	\$3,841,606,121	79.79%
1/1/2003	\$13,947,271,000	\$17,550,939,000	\$3,603,668,000	79.5%	\$3,779,298,060	95.35%

## State Retirement System

### NOTES TO FINANCIAL STATEMENTS (Continued)

#### FOR THE FOUR YEAR PERIOD ENDING DECEMBER 31, 2003

#### NOTE 6 - MEMBERSHIP EXHIBIT

<b>Retirement in Past Years</b>	<b>1994</b>	<b>1995</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>
Superannuation	1,592	1,785	2,226	1,508	1,481	1,692	2,224	2,342	6,458	3,775
Ordinary Disability	59	63	67	31	41	35	*	*	*	*
Accidental Disability	184	188	187	84	73	60	*	*	*	*
<b>Total Retirements</b>	<b>1,835</b>	<b>2,036</b>	<b>2,480</b>	<b>1,623</b>	<b>1,595</b>	<b>1,787</b>	<b>2,224</b>	<b>2,342</b>	<b>6,458</b>	<b>3,775</b>
Total Retirees, Beneficiaries and Survivors	43,638	43,623	44,067	44,220	43,425	43,765	44,065	44,358	49,567	51,827
<b>Total Active Members</b>	<b>81,675</b>	<b>82,992</b>	<b>82,539</b>	<b>82,940</b>	<b>86,666</b>	<b>83,073</b>	<b>87,118</b>	<b>88,992</b>	<b>81,973</b>	<b>80,122</b>
<b>Pension Payments, Dollars in thousands</b>										
Superannuation	\$345,254	\$353,731	\$365,823	\$408,834	\$404,800	\$428,544	\$458,314	\$508,824	\$610,667	\$679,004
Survivor/Beneficiary Payments	26,638	27,563	28,467	30,200	31,205	32,747	34,646	36,658	39,046	43,269
Ordinary Disability	8,385	8,394	8,297	8,413	8,363	8,414	8,553	8,771	8,770	8,621
Accidental Disability	36,033	37,876	39,734	41,747	44,051	46,815	49,071	54,379	56,465	60,620
Other	<u>33,884</u>	<u>33,575</u>	<u>34,594</u>	<u>15,083</u>	<u>35,263</u>	<u>84,558</u>	<u>125,632</u>	<u>58,907</u>	<u>94,707</u>	<u>80,357</u>
<b>Total Payments for Year</b>	<b><u>\$450,194</u></b>	<b><u>\$461,139</u></b>	<b><u>\$476,915</u></b>	<b><u>\$504,277</u></b>	<b><u>\$523,682</u></b>	<b><u>\$601,078</u></b>	<b><u>\$676,216</u></b>	<b><u>\$667,539</u></b>	<b><u>\$809,655</u></b>	<b><u>\$871,871</u></b>

Note: \* Included in superannuation

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